

Sales of "canned" computer software are taxable retail sales in Illinois regardless of the means of delivery of the software. See 86 Ill. Adm. Code 130. 1935. (This is a GIL).

March 28, 2002

Dear Xxxxx:

This letter is in response to your letter dated January 15, 2002. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

I am seeking information regarding Illinois' sales and use tax laws. I work for a company in STATE that provides transcription service and document storage. In the future this service may expand to your state.

There are three ways a client may use our services: 1) transcription only; 2) transcription and limited document storage; and 3) transcription and full document storage. Each option has different requirements for using the service.

Under the first two options clients will dictate documents that our firm will transcribe and save on our server located outside your state. When the clients retrieve these documents they will do so on-line. The product only will be tangible in that the clients most likely will print out the contents at some point. The clients will be charged for the preparation of the documents and an access fee to retrieve them off our server. They will not be charged any license, right-to-use or software fees. Are we responsible for any taxes to your state under these circumstances?

The third option allows the clients full document storage as well as transcription services. By choosing this option they actually will be purchasing a software right-to-use license. In this circumstance, we will be reselling the necessary software. The client never will tangibly receive this software as it will be housed on our server located outside your state. However, they will receive, via U.S. Mail, the appropriate software license. What taxes, if any, are we responsible for in this scenario?

Any information you can provide regarding these questions would be greatly appreciated. Thank you very much for your assistance.

## DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See the enclosed copy of 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. Illinois Retailers' Occupation and Use Taxes do not apply to sales that do not involve the transfer of tangible personal property to customers.

Please note that information that is downloaded is generally not taxable because it is considered an intangible. The Department recently amended 86 Ill. Adm. Code 130.2105 (copy enclosed) to read, in part, as follows:

“Information or data that is downloaded electronically, such as downloaded books, musical recordings, newspapers or magazines, does not constitute the transfer of tangible personal property. These types of transactions represent the transfer of intangibles and are thus not subject to Retailers' Occupation and Use Tax. However, downloads of canned software, as defined more fully in Section 130.1935 of this Part, are subject to Retailers' Occupation and Use Tax.”

However, if you transfer such information in a tangible format, such as on tape or disk, such transfer is taxable as either a Retailers' Occupation Tax or a Service Occupation Tax transaction depending on whether the item is customized. When you sell an item standard enough to be stocked for sale to the public generally, i.e., one that is not customized to the specifications of a particular purchaser, the entire charge for the product is subject to Retailers' Occupation Tax. If the item, however, were customized for a particular purchaser, it would be subject to the Service Occupation Tax. See the enclosed copy of 86 Ill. Adm. Code 140.101 that explains the application of the Service Occupation Tax.

Generally, sales of “canned” computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 130.1935. Sales of software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of Section 130.1935.

Under the third option described in your letter, you state that the customers will be purchasing a “software right-to-use license.” If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;

- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

The Retailers' Occupation Tax Act defines "computer software" as

*"a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being received by or communicated to humans, and includes prewritten or canned software that is held for repeated sale or lease, and all associated documentation and materials, if any, whether contained on magnetic tapes, discs, cards, or other devices or media, but does not include software that is adapted to specific individualized requirements of a purchaser, custom-made and modified software designed for a particular or limited use by a purchaser, or software used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease. For the purposes of this Act, computer software shall be considered to be tangible personal property."* (emphasis added) 35 ILCS 120/2-25.

Your letter does not contain sufficient information for us to make a specific ruling regarding the software transaction described as the "third option" in your letter. However, we would preliminarily note that Section 2-25 of the Retailers' Occupation Tax Act set out above clearly applies to software no matter how it is transmitted or used. Section 2-25 states that taxable software includes a set of statements or instructions to be used "directly or indirectly in a computer in order to bring about a certain result." The language of Section 2-25 broadly states that the software can be used to bring about a certain result "by any method now known or hereafter developed . . ."

Please note that Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See the enclosed copy of 86 Ill. Adm. Code 495. As you can see from 86 Ill. Adm. Code 495.100(c), charges for automated information retrieval or data processing are not taxable. If retailers provide both transmission (such

as telephone line charges) and data processing services, the charges for each must be separately disaggregated and identified in the books and records of the retailers. If such charges are not disaggregated in this manner, then all charges are taxable.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton  
Associate Counsel

TDC:msk  
Enc.